MEMO ON THE AID TO FAMILIES WITH DEPENDENT CHILDREN PROGRAM

Aid to Families with Dependent Families(AFDC) was created under the Welfare Title of the Social Security Act in 1935. Although general rules and guidelines are set out by the federal government, details of administration and levels of benefits are largely within the control of the individual states. Under current law the federal government pays 50% of administration costs and makes percentage matching grants to individual states for actual welfare payments. Percentages are based on the income per capita in individual states and varies from 50% to 83%. Eligible recipients are "needy families containing at least one child who is under 18(or a full time student under age 21) who is living in the home of his parent or other specified relative, and who has been deprived of support because of the death, absence from the home or incapacity of a parent...or unemployment of the father."[1]

TIME SERIES DATA ON AFDC PROGRAM(1936-1973)[2]

	Aid to families with dependent children (THOUSANDS)			Aid to families with dependent children MILLION
	Families	Total recipients[3]	Children	
1936	162	546	404	$49.7
1940	372	1,222	895	133.4
1945	274	943	701	149.5
1950	651	2,233	1,661	547.2
1951	692	2,041	1,523	548.8
1952	696	1,991	1,495	538.0
1953	647	1,941	1,464	544.0
1954	604	2,173	1,639	573.1
1955	602	2,192	1,661	612.2
1956	615	2,270	1,731	634.9
1957	667	2,497	1,912	716.8
1958	755	2,486	2,181	839.9
1959	776	2,946	2,265	937.2
1960	803	3,073	2,370	994.4
1961	916	3,566	2,753	1,148.8
1962	932	3,789	2,844	1,289.8
1963	954	3,930	2,951	1,355.5
1964	1,012	4,219	3,170	1,496.5
1965	1,054	4,396	3,316	1,664.1
1966	1,127	4,666	3,526	1,849.9
1967	1,297	5,309	3,986	2,249.7
1968	1,522	6,086	4,555	2,823.8
1969	1,875	7,313	5,413	3,533.3
1970	2,552	9,659	7,033	4,857.2
1971	2,918	10,653	7,707	6,230.4
1972	3,122	11,065	7,984	7,019.6

	Aid to families with dependent children	
	Per family	Per recipient
1936	$29.85	$8.80
1940	32.40	9.85
1945	52.05	15.15
1950	71.45	20.85
1951	75.80	22.00
1952	82.10	23.45
1953	82.30	23.20
1954	83.70	23.25
1955	85.50	23.50
1956	91.50	24.80
1957	95.15	25.40
1958	100.40	26.65
1959	103.70	27.30
1960	108.35	28.35
1961	114.65	29.45
1962	119.10	29.30
1963	122.40	29.70
1964	131.30	31.50
1965	136.95	32.85
1966	150.10	36.25
1967	161.70	39.50
1968	168.15	42.05
1969	176.05	45.15
1970	187.95	49.65
1971	190.90	52.30
1972	191.20	53.95

If we use the assumption that the same percentage of people 21 or under in the AFDC group attend college as in the rest of the population, it can be calculated that 10.2% of all children under the age of 18 were receiving benefits under the AFDC program in 1972[4]. The corresponding figure for people ages 18-21 is 3.4%. The proration assumption clearly biases the former figure downwards and the latter figure upwards. The Senate Committee report estimates that 20 - 23% of those receiving AFDC payments are technically ineligible. Thus it appears that roughly 8% of children under 18 years of age are eligible for the program.

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1. 92nd. Congress, Senate Committee Report #1230.
2. Department of HEW, Social Security Bulletin, Annual Statistical Supplement, 1972.
3. Proration data was taken from Bureau of the Census, Current Population Reports, Series P-25, #473(January 1972) and # 476(February 1972).

Welfare: Transfer Payments June 5th

Regardless of how the funds that are used are raised, a system of transfer payments involves a transfer of command over consumption goods from the active members of the labor force to the recipients of the transfer payments - who are implicitly an inactive group.

The peculiar contributory social security schemes, which create a substantial gap between the wage costs per employee so an enterprise and the disposable income of an employed worker clearly reveals the essential nature of a transfer payment scheme. However, even if the transfer payments are financed by a tax that is ostensibly on profits, the 'widows' cruise' nature of profits implies that the transfer will be from the real income of the employed workers to the recipients of transfer payments: (Note that if the social security taxes are greater than transfer payments - so that some of the taxes are savings and so a substitute for profits as an offset to investment, the effect of the transfer scheme is in part offset by decrease in the required mark upon labor costs.

In regard to a social security tax of λ % on wages paid by both the employee and the employer, the worker receives an income that is $(1-\lambda)w$ and the labor costs of output, which enter the supply price of goods and upon which the profit mark up is added, is $(1+\lambda)w$. The price of output for any given investment output $P_I Q_I$ will incorporate both the workers and the employers contributions; the ability of the worker to buy back what his labor has helped produce is decreased by the social security mark up on workers cash income. This supply price-wage income $S+b$ is transferred by the social security scheme to the beneficiary.

The transfer payments will - perhaps with a lag rise at the same rate as P_C.

We can therefore have a wage price spiral that starts from transfer

payment increases and runs through wage increases to further increases in transfer payments. Any scheme of transfer payments must be disciplined by a recognition that no matter what the tax scheme, the transfer payment mechanism involves transferring income from workers to the recipients of transfer payemtns.

Transfer Payments financed by profits taxes -

Let us assume that profit recipients do not spend any of profits on consumption, but that μ_T of profits are taxed to pay for transfer payments - i.e. transfer payments equal $\mu_T \tilde{\Pi}$. We still have that

(ignore $W_S N_S$) $P_C Q_C = W_C N_C + W_I N_I + \tilde{T}$

$= W_C N_C + W_I N_I + \mu_T \tilde{\Pi}$

$P_C Q_C - W_C N_C = \tilde{\Pi}_C$

$P_I Q_I - W_I N_I = \tilde{\Pi}_I$

$\tilde{\Pi} = \tilde{\Pi}_C + \tilde{\Pi}_I$

exogenously determined $P_I Q_I$ we have $\tilde{\Pi} = P_I Q_I / (1 - \tilde{T}_\Pi)$

I.E. $\tilde{\Pi}$ rises to compensate for the transfer payments.

Note that if transfer payments are less than $\tilde{T}_\Pi \tilde{\Pi}$ - the social security fund is accumulating - then only $\mu \tilde{T}_\Pi \tilde{\Pi} = T$, $0 < \mu < 1$ then $\tilde{\Pi} = P_I Q_I / (1 - \mu \tilde{T}_\Pi)$ which is less than $P_I Q_I / (1 - \tilde{T}_\Pi)$ - an accumulating social security trust fund offsets part but not all of the rise in prices implicit in the tax rate on profits.

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If social security taxes are levied on wages and on the employees, as our scheme has it, and if taxes equal transfers we have

$$T = 2\lambda w_c N_c + 2\lambda w_I N_I$$

$$P_c Q_c = (1-\lambda) w_c N_c + (1-\lambda) w_I N_I + T.$$

$$= (1-\lambda) w_c N_c + (1-\lambda) w_I N_I + 2\lambda w_c N_c + 2\lambda w_I N_I$$

$$P_c Q_c = (1+\lambda) w_c N_c + (1+\lambda) w_I N_I.$$

$$P_c Q_c - (1+\lambda) w_c N_c = \Pi_c$$

$$P_I Q_I - (1+\lambda) w_I N_I = \Pi_I$$

$$\Pi = \Pi_c + \Pi_I = P_c Q_c + (1+\lambda) w_c N_c - (1+\lambda) w_I N_I + P_I Q_I$$

$$\Pi = \Pi_c + \Pi_c = P_I Q_I.$$

$$P_c = \frac{(1+\lambda) w_c}{Av} \left(1 + \frac{w_I N_I}{w_c N_c} \right)$$

$$\frac{P_c}{w_c} = (1+\lambda) \left(1 + \frac{w_I N_I}{w_c N_c} \right) \quad (?) \text{ check.}$$

In the basic price level formula the higher the ratio of transfer payments to wage income the higher the price level of consumer goods - the lower the real wage of workers in consumer goods. Any policy change which increases transfer payments will lower real wages - unless it is offset by a rise in the average productivity of workers or by a rise in the ratio of employment in consumption to total employment. Any effort of workers in consumption goods to sustain their real wage by increasing their money wage will only affect the price level of consumption goods unless excepting as it lowers the ratio of transfer payments to wage income.

Thus there is an inflationary spiral that can be set off by a rise in transfer payments. The rise in transfer payment schemes increases the price level and trade union pressure by affected workers raising the money wage. Furthermore if all or a portion of transfer payments are indexed, then a cumulative apiral can be triggered.

It is important to note that a rise in private pensions means no rise in P_c relative to disposable workers income for as the fund is being accumulated it finances I; thus for a given $P_I Q_I$, we get a smaller because of the transfer of μW to savings. However when pension income and pension financed spending increases, the effect is to raise consumption out of profit income, which raises the ratio of P_c to W_c; a decrease in real wages or for given money W_c a rise in prices.

Note: $P_c Q_c = W_c N_c + W_I N_I$

$$= W_I N_c \left(\frac{W_c}{W_I} + \frac{N_I}{N_c} \right)$$

$$P_c = \frac{W_I}{AV_c} \left(\frac{W_c}{W_I} + \frac{N_I}{N_c} \right)$$

$$P_c = \frac{1}{Av} \left(W_c + W_I \frac{N_I}{N_c} \right)$$

so that $dw_I > 0 \rightarrow dP_c > 0$

Bigness is bad

Given that "bigness is bad" how do we get out from under the current industrial structure with its emphasis upon bigness. Of course no change is costless: the view has to be that the benefits from arranging our industrial structure so that the market can act as an effective control device, when added to the benefits to a democratic society from constraining the private power and ability to corrupt if giant organizations, more than compensates for the current costs - if any - of the reorganization of industry. While it is clear that such benefit cost relations are hard to calculate - the value of democratic institutions being especially difficult to price - it is clear that doing anything serious will involve at least adjustment costs.

The emphasis in what follows is upon manufacturing and service organizations. Public utilities and some manufacturing processes where the "chips" are big are another issue.

There are some relatively easy and quite painless things that can be done. The giant corporation is a creature of the tax laws - which presently tilt in favor of the growth of giant corporations. Reforms of the tax laws should be undertaken to make voluntary devaluation profitable. T oday the corporate income tax - after a minor exemption of $25,000 income from taxation - is not progressive. One way to go in favoring the development of decentralized business enterprises is to make the corporate income tax progressive. A rate structure can be determined which yields the same income as the current tax schedule but which follows the principle of the personal income tax. The following is an example of a "progressive corporate tax schedule: the first half million of corporate profits can

be taxed at 20%, the next million at 30%, the third at 40%, all between 3.5 millions and 5.0 millions at 50%, and all corporate net income above 5 million can be taxed at 60%. Similarily the investment tax credit - in itself a highly undesirable tax subsidy - can be tilted in favor of smaller firms. For example the investment tax credit can be 15% - for firms with sales of less than 5 million, 12% for firms with sales of from $5 to $50 million, 10% for firms with sales of between 50 million to 100 million, and 8% for firms with sales of more than $100 million. An investment tax credit scheme that is brased in favor of the small firms should provide for a cash rebate if the net taxable income is less than the investment tax credit. I suggest that the maximum rebate in any one year be $50,000 and that no firm can get more than $125,000 in cash rebates over a period of five years.

C orporations owning corporations are also at issue; I would suggest that the income received by a corporation as dividends from a subsidiary be exempt from doublt income taxation only if it is paid out in dividends; that the ownership of one corporation by another be penalized in this fashion.

However the tax reforms designed to constrain bigness are part of a permanent reform. The problem is to develop programs for a transition from the clearly not satisfactory present to a better, though not perfect, situation. How to go about "breaking up" or "cutting down to size" the clearly too big corporations.

First of all the too big corporations are typically a conglomoration of separate product lines and of geographically separate organizations and operations. Positive incentives

for product line and geographical devolution should be devised. Thus favorable tax treatment of spin-offs should be intruded into the tax system. For example if a corporation is spun off from a parent by means of a distribution of stock to a present stock holder, capital gains for the stockholder receiving shares in the spun off corporation can be computed in the basis of the initial price of the stock in the successor company, rather than on the basis if the value of the initial purchase price of stock in the parent company, whereas capital losses can be taken on the basis of a pro-rated portion of the purchase price of the initial company.

An additional way to spin-off a company is to issue stock to the public, the proceeds of which are used to pay-off the owning company. If such receipts are greater than the book value of the assets assigned to the spun-off company then the company spinning off the new company will presumably receive a capital gain. One way in which spin-offs can be encouraged is by forgiving all or part of such capital gains. However the "capital gain" that accures to the original corporation is due to the favorable prospects of the spun-off company. I would suggest that the capital gain tax be forgiven from such spin-offs and the amount that would have been taxes be split three ways: one third as a non-taxable disbursement to the stock holders in the originating corporation, one third to the successor corporation and one-third to remain with the original corporation.

This capital-gains forgiving provision has some real positive virtues; the distribution suggested for the capital gains is but one of many alternatives. The positive virtue of forgiving capital gains to the initial corporation for organizations that

it spins off is that it serves as an inducement and a pay off for technical innovation and progress. A firms research will often come up with results that are peripheral to the main line of business - product ideas can be developed which are not central to the major lines of business of the originating firms. The objective here is to induce the development of independent companies based upon the research and innovation capabilities that larger corporations may have.

We can visualize that such inducements to spin offs will not do the entire job. For such firms that cannot or willnot readily cut their size down to a limit which is reasonable, outright nationalization - or socialization - should be a transitory stage in the evolution of the industry.

The trouble with nationalization and socialization as practiced in many places is that it is viewed as a final rather than a transitory state. Furthermore the tendency is to protect the nationalized firm or industry against market competition. However if socialization is viewed as one step in the development of an economy in which market forces are the major control device, then the possibility and the desirability of eventually returning the operation - once it conforms to the size and operating procedures which are consistent with free markets - to private ownership is a guiding principal in public policy. Secondly if socialization is viewed as a transitory step - because in time the industry will be so organized that the market mechanism can do the regulating and control job - then at no time will the

nationalized industry be protected from competition. Furthermore once the transition to nationalized operations are made, in principle these nationalized industries should not receive a subsidy. Furthermore if there is a subsidy, because in the complex system of taxes that are prices a cross subsidization of industry A by industry B is desirable, then the subsidy should be available to both private and public operations.

Note that in transportation we had private ownership and maintenance of the road bed in the railway industry and public ownership and maintenance of the road-bed for trucking; public ownership of the airports plus public supply of traffic control operations for airlines. In the special taxes that go to support and pay for highways, elaborate cross subsidizations between different types of vehicles and different users exist. The idea is not that cross-subsidization through prices and net revenues be avoided - that is impossible where capital and overhead costs are large and are where the capital assets are used to produce joint products - the basic idea is that public policy must recognize that complex cross subsidization possibilities exist and that the prices which generate the revenues for such cross subsidization are essentially political in nature. Once it is recognized that gasoline taxes paid by households in principle are available to pay for the highways that are used by trucks, then the query arises as to why shouldn't these taxes also be available to pay for the road beds of railroads. Any drive who was 'abused' on the road by a giant truck would at the time of his abuse been willing for gasoline taxes to be used to get the giant trucks off of the highways and get that freight traffic

into railroads.

If an organization is too big and it is viewed that either the bignessis inevitable, which I doubt is true for most manufacturing, or that the costs of dissolving the firm or the

of the job are such that it will not be expeditiously completed under the private management, then a socialization of the firm - or industry - with an end in view of devolving as much as possible to private enterprise should be undertaken.

A firm such as General Motors is clearly too big. The sorry state of the American motor industry is in good part a reflection of the beaureaucratic stagnation of the automobile industry during the poast-war period when General Motors dominance increased. The problems of devolving General Motors into component parts may illustrate some of the problems and prospects of the suggested approach.

Certain hypothesis about the nature of General Motors need to be made in sketching a first approximation to the program. First of all there are divisions of the organization which are virtually independent of the production of components for and the assembly of automobiles. Groups such as the Frigidaire, the Deisal railroad engine, and perhaps the Bus manufacturing operation can be spun off without any difficulty. Such spin-offs should be the first and easiest part of the procedure by which General Motors is cut down to size.

There are also parts of General Motors which manufacture components such as spark plugs and batteries, both for General Motor cars and for the maintenance and replacement market. These organizations can also be split off without any difficulty.

When it comes to the production of components for and the assembly of automobiles the question is how independent the various product lines are, one from another , arises. In terms of the wholesaling and retailing operation it is clear that the various automobile lines, and the truck operation are quite independent. Breaking up General Motors will cause few if any problems on that score. In terms of the manufacturing process we can also assume that Cadillac and General Motors Truck division can be easily set up as separate operations.

What is left is the Chevrolet, Buick, Pontiac, and Oldsmobile operations. In these product lines there is some integration in bodies, engines, transmissions etc. As a first step it might be necessary to socialize these relatively integrated operations - with the object in mind that as soon as it is feasible the Buick, Pontiac, and Oldsmobile divisions would be set up as independent, non-overlapping corporations which would thereafter have an independent existence. The transition towards independent private organizations might require the setting up of some of the plants as contract manufacturing establishments - such as once existed and prosperred in the automobile industry. In fact independent engine , transmission and frame manufacturing establishments would ease entry and would also help the profitability and product lines of the other, non residual General Motors outfits.

As an experiment in the feasibility of a partially socialized partially privatized industry, I would keep the Chevrolet operation under government ownership, with the proviso that after a transtion it would be operated as a profit-maximizing firm without government subsidy or preference. It should pay income taxes, borrow without full faith and creidt of the government, and bargain with its workers as if it were private. The object would be to determine

if such a profit maximizing automobile corporation could act as a yardstick to determine the prices and products of the industry. If over time, the private companies are sufficiently efficient to make the government owned operation lose money os that this Chevrolet operation is forced into bankruptcy, the view should be "so be it" - if it cannot cut the mustard in a competitive environment it should be abandoned.

Of course General Motors Acceptance Corporation, which has always been an anamoly should be spun off immediately. This is a general principal - all of the captive financial arms of the large corporations should be spun off as independent companies; and many of these finance companies should be liquidated. They are a peculiar set of organizations whose only function has been to give the parent company a competitive edge which is unrelated to the parent's productivity or the virtue of its products.

One way to finance the operation of breaking up General Motors is to issue "bonds" of the socialized corporation in exchange for the bonds and stocks of General Motors that are in the market. The new bonds should be issued one for one for the old bonds; the bonds that are issued for the outstanding stock should pay an interest rate which is some premium over the rate paid as dividends on the common shares. These equity exchange bonds should also be redeamable at face value for the stock of the divested corporations as they are set up. Thus as the Cadillac division is spun off as a private corporation, a price will be set by the underwriters for the Cadillac stock and these bonds can be used as currency to purchase equities of the Cadillac C ompany. Similarily for the other spin off operations. The expectation I would have is that the spun-off parts iwll redeem a very large

part of the total. After we are left with the socialized portion of the company, the remaining outstanding bonds will be called - and the residual if any will become part of the government debt. If after a while the decision is made to privatize the remaining part, then there might well be a residual net government debt that results from the process. This government debt is analagous to a war debt; the price that is paid in terms of future taxes and thus future transfer payments for the gain to democracy from diminishing private power.

Of course, by any absolute standard the Ford Motor Car Company is also "too big". It too should be induced to divest itself of all non-automobile manufacturing and assembly operations. Its foreign operations should be divested - if not to local ownership then at least to a domestic corporation that at least initially does its manufacturing oversees (add to G.M.)

However the Chevrolet operation that remains fater divesting General Motors of other operations would be as large or almost as large as the Ford Motor Company. The approach towards socialization and controlling bigness should be sequential: one firm at a time aside from the general rules about taxation and divesture.